

## DEPARTMENT OF STATE REVENUE

04-20130243.LOF

**Letter of Findings Number: 04-20130243**  
**Use Tax**  
**For Tax Years 2010-2012**

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**ISSUE**

**I. Use Tax– Manufacturing Equipment.**

**Authority:** IC § 6-8.1-5-1; IC § 6-2.5-2-1; IC § 6-2.5-3-2; IC § 6-2.5-5-3; [45 IAC 2.2-5-10](#); [45 IAC 2.2-3-4](#).

Taxpayer protests the imposition of use tax on certain manufacturing equipment.

**STATEMENT OF FACTS**

Taxpayer is an Indiana manufacturer. As the result of an audit, the Indiana Department of Revenue ("Department") determined that Taxpayer owed use tax. The Department therefore issued proposed assessments for use tax and interest. Taxpayer protests a portion of these proposed assessments. An administrative hearing was held and this Letter of Finding results. Further facts will be supplied as necessary.

**I. Use Tax– Manufacturing Equipment.**

**DISCUSSION**

Taxpayer protests the imposition of use tax on its "Scrap removal system, baling equipment and related parts." Taxpayer states that the equipment is necessary as part of its production process and is therefore exempt from Indiana sales and use tax. The Department notes that the burden of proving a proposed assessment wrong rests with the person against whom the proposed assessment is made, as provided by IC § 6-8.1-5-1(c).

The Department first notes that sales tax is imposed by IC § 6-2.5-2-1, which states:

(a) An excise tax, known as the state gross retail tax, is imposed on retail transactions made in Indiana.

(b) The person who acquires property in a retail transaction is liable for the tax on the transaction and, except as otherwise provided in this chapter, shall pay the tax to the retail merchant as a separate added amount to the consideration in the transaction. The retail merchant shall collect the tax as agent for the state.

Use tax is imposed under IC § 6-2.5-3-2(a), which states:

An excise tax, known as the use tax, is imposed on the storage, use, or consumption of tangible personal property in Indiana if the property was acquired in a retail transaction, regardless of the location of that transaction or of the retail merchant making that transaction.

[45 IAC 2.2-3-4](#) further explains:

Tangible personal property, purchased in Indiana, or elsewhere in a retail transaction, and stored, used, or otherwise consumed in Indiana is subject to Indiana use tax for such property, unless the Indiana state gross retail tax has been collected at the point of purchase.

Therefore, when tangible personal property is used, stored, or consumed in Indiana, use tax is due unless sales tax was paid at the time of the transaction.

The Department next refers to IC § 6-2.5-5-3(b) which states:

Except as provided in subsection (c), transactions involving manufacturing machinery, tools, and equipment are exempt from the state gross retail tax if the person acquiring that property acquires it for direct use in the direct production, manufacture, fabrication, assembly, extraction, mining, processing, refining, or finishing of other tangible personal property. (Emphasis added).

Taxpayer manufactures cardboard boxes. During the cutting of the cardboard, a scrap removal system collects the scrap that falls below the production machinery. The removal system then carries the scrap to the baler where it is bundled for shipment. Taxpayer argues that the scrap removal system and baler both fall within this exemption. Taxpayer explains, "If the scrap is not removed [the product] cannot be further processed, therefore the removal of the scrap has a direct effect on the boxes being produced."

While the scrap removal system may be necessary, it does not satisfy the "double direct" test provided in [IC 6-2.5-5-3\(b\)](#) which states that the property must be directly used in direct production. Here the scrap remover is not part of direct production, but is instead part of post production. Once the scrap has been punched out, it is no longer part of production. Therefore the machinery used solely for the removal of the post production scrap is not considered part of direct production.

With regards to the baler, Taxpayer argues "we are however engaged in producing other tangible property for sale, that being bales of paper."

The Department refers to [45 IAC 2.2-5-10\(k\)](#) which states:

"Definitions. Processing or refining is defined as the performance by a business of an integrated series of operations which places tangible personal property in a form, composition, or character different from that in which it was acquired. The change in form, composition, or character must be a substantial change.

Operations such as distilling, brewing, pasteurizing, electroplating, galvanizing, anodizing, impregnating, cooking, heat treating, and slaughtering of animals for meal or meal products are illustrative of the types of operations which constitute processing or refining, although any operation which has such a result may be processing or refining. A processed or refined end product, however, must be substantially different from the component materials used." (Emphasis added)

Here the Taxpayer is not engaged in the production of a new or refined end product. While Taxpayer may sell the scrap, it is not a "product" manufactured by Taxpayer. The scrap is a by-product of Taxpayer's manufacturing process that Taxpayer sells in secondary markets. The scrap is not an item that is manufactured by the transformation of component raw materials into a distinct product. Taxpayer begins with scrap paper, and ends with scrap paper. Taxpayer does not make a new, "substantially different product." Therefore, in this instance, the removal system and bailer that are used to transport and bundle the scrap do not qualify for exemption. As a result, Taxpayer has not met its burden to prove the proposed assessment wrong, as provided by IC § 6-8.1-5-1(c).

#### **FINDING**

Taxpayer's protest is respectfully denied.

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